DELHI COLLEGE OF ENGINEERING

LIBRARY

Kashmiri Gate, Delhi-110006

Accession No.

Class No.

Book No.

DELHI COLLEGE OF ENGINEERING

Kashmiri Gate, Delhi-110006

LIBRARY

DATE DUE

For each day's delay after the due date a fine of **10 Paise** per Vol. shall be charged for the first week, and **50 Paise** per Vol. per day for subsequent days.

Borrower's No.	Date Due	Borrower's No.	Date Due

CONTEMPORARY MONETARY THEORY

NUMBER 443 OF THE
STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW
EDITED BY THE
FACULTY OF POLITICAL SCIENCE
OF COLUMBIA UNIVERSITY

CONTEMPORARY MONETARY THEORY

Studies of Some Recent Theories of Money, Prices, and Production

By RAYMOND J. SAULNIER
ASSOCIATE PROFESSOR IN ECONOMICS
COLUMBIA UNIVERSITY

IN LITTERIS LIBERTAS
1754·1893

COLUMBIA UNIVERSITY PRESS
NEW YORK · MORNINGSIDE HEIGHTS

Copyright 1938, Columbia University Press, New York

First printing 1938
Second printing 1939
Third printing 1941
Fourth printing 1947

Published in Great Britain and India by Geoffrey Cumberlege,
Oxford University Press, London and Bombay

MANUFACTURED IN THE UNITED STATES OF AMERICA

TO

MY MOTHER AND FATHER

PREFACE

THE main purpose of this study is to summarize and to examine the theories of four of the outstanding recent writers on monetary and business cycle problems: R. G. Hawtrey, D. H. Robertson, F. A. von Hayek, and J. M. Keynes. The emphasis throughout is on the concepts and analytical procedures which are involved in the different theoretical systems. Because it is no longer possible to distinguish clearly between monetary theory and business cycle theory, the problems relevant to both of these branches of economic study are dealt with as one. It is likewise impossible to criticize the concepts of theory without taking account of the proposals for stabilizing economic activity which the various writers have advanced. For this reason each of the writers concerned is studied not only with respect to the analytical procedures which he utilizes but also with respect to his end conclusions as to appropriate monetary policy.

Because there are considerable differences between the systems of ideas that are brought under examination, it is not possible to develop each of the four sections of this work on the same general scheme. There are, however, certain common elements in the four main divisions of this volume. In each of the separate studies we have dealt with (a) the general nature of the theoretical approach, (b) the important terminology of the theory, (c) the main concepts and analytical devices which are used, (d) the theory of price movements, (e) the explanation of the " cycle " which is advanced and (f) the relation between the particular analytical method and the control program which is sponsored.

The materials that have been used are the published books and journal articles of the four writers and also those of other writers who have directly or indirectly developed criticisms of the theories with which we are concerned. It has not been necessary to cover the whole literature in order to satisfy the

aims of this work. Only the more important ideas and lines of reasoning have been examined. A selected bibliography of the material in this field is found in Appendix A.

The order in which the different theoretical systems are discussed was suggested mainly by the chronological development of ideas in this field. R. G. Hawtrey is discussed first because his *Currency and Credit* is, in a certain sense, the first of the "modern" books on the theory of money. It is true, of course, that what we know about the history of monetary theory indicates that theories now current have rather long histories. Nevertheless, the treatment of money from the credit point of view and the consideration of the theory of credit expansion and contraction, which is the major concern of present-day monetary theory, owes much to Hawtrey's early work. The order in which the other writers are discussed raises, I believe, no special questions. That Robertson's *Banking Policy and the Price Level*, which carries on into the field of monetary theory the intellectual apparatus developed by Alfred Marshall, claims a place of high distinction in the history of monetary and business cycle theory is a proposition not, it seems to me, open to debate. His analysis of the operation of non-monetary and monetary forces and their influence on the process of capital formation constitute what appear to me to be his greatest contributions and in these matters his priority seems unquestionable. That body of theory developed by F. A. von Hayek, which is, as he indicates, a further development of Böhm-Bawerk's capital theory, is concerned with the same general problem of capital formation and the relation between money and the operation of the whole economic system. J. M. Keynes is discussed last because we concern ourselves mainly with the *General Theory of Employment, Interest and Money.* A different order of treatment, on a chronological basis, would be required were we to discuss his earlier *Treatise on Money.* As I have tried to show in discussing Keynes's theory, his main interest is in effecting the reformulation of general economic theory which he believes to be neces-

sary in order to enable one to discuss adequately the relation of money to the economic system. This is the aspect of Keynes's work to which I have given most attention and the one which seems to me to be the most important.

The difficulties of making a study of this kind are quite apparent. Ideas in this branch of economics are many and diverse, and the important ones seem to be regularly the most difficult to comprehend. Furthermore, not only does the exposition of the ideas leave much to be desired but also the principal writers are currently producing new ideas or variations upon older concepts. The former situation might, perhaps, have been avoided, but the latter is inescapable in a field of study that is in process of development.

Because of these major difficulties I do not feel at all sure that the interpretations which I have made are correct in all instances or that the comments which I have made on the various ideas are in all cases valid. But if such errors have been committed they are inadvertent.

This task of tracing some of the more important developments in contemporary monetary theory was undertaken at the suggestion of Professor James W. Angell of Columbia University and was carried out under his guidance. The acknowledgment I owe and gratefully make to Professor Angell is due both for his constant critical appraisal of ideas and for his kind and generous personal attitude. To my early teachers, Professor Harry M. Fife of Middlebury College and Professor Lloyd L. Shaulis of Tufts College, I owe great intellectual debts. Among my former teachers and present colleagues at Columbia University there are many to whom I wish to express special thanks. Professors W. C. Mitchell, J. M. Clark, B. H. Beckhart and A. D. Gayer and Dr. Harold Barger have read the typescript in whole or in part and have given me the benefit of their criticisms. I want especially to express my gratitude to Prof. B. H. Beckhart for his indispensable aid in connection with the work of publication. To my friend and colleague Professor Horace Taylor I owe a profound debt for assistance

with many of the points of interpretation and appraisal that have been raised in the course of this study and for his constant personal encouragement. Without the aid and sympathetic support of these and many others this work could not have been completed. However, for the interpretations and criticisms advanced in this volume I am solely responsible.

The following firms have very kindly permitted me to make quotations from books published by them: Jonathan Cape, Ltd., Harcourt, Brace and Co., P. S. King and Son, Ltd., Longmans, Green and Co., Macmillan Co., McGraw-Hill Book Co., National Bureau of Economic Research, Inc., Oxford University Press (Royal Institute of International Affairs) and George Routledge and Sons, Ltd.

CONTENTS

PART I

R. G. Hawtrey

CHAPTER I

CHAPTER II

CHAPTER III

CHAPTER IV

CHAPTER V

PAGE

CHAPTER IV

CHAPTER V

CHAPTER VI

CHAPTER VII

PART III

F. A. VON HAYEK

CHAPTER I

CHAPTER II

PAGE

PART V

Concluding Remarks

APPENDIX

Bibliographical Note

PART I

R. G. HAWTREY

CHAPTER I

INTRODUCTION

It is the purpose of this essay to discuss those writings of Mr. R. G. Hawtrey which relate to the theory of money and prices and to the explanation of the business cycle. As in the other sections of this work, we shall discuss only the principal features of the theoretical system. Our principal interest is in the analytical tools which are utilized and in their applications to various economic problems.

Hawtrey is often referred to as a "monetary" theorist so far as concerns his explanation of the business cycle. In the next chapter of this essay we shall state his position on this matter and attempt to show what, in his view, is meant by a "monetary" approach to business cycle problems. In Chapter III we shall summarize the theoretical apparatus which Hawtrey utilizes to systematize his analysis of the phenomena which he considers influential in determining changes in the value of money. This includes a statement of his version of the quantity theory of money. Because an interesting equilibirum approach is clearly discernible in Hawtrey's work, and because this theoretical concept is an essential element in his theory of money, prices, and production, a separate section, Chapter IV, is devoted to this topic. The various aspects of his equilibrium concept are presented and it is shown how the idea is utilized in explaining the various problems with which he is concerned. In Chapter V we discuss his theory of the business cycle. Here, as in the corresponding section in the essay on D. H. Robertson, only those elements in Hawtrey's work which are directly related to the monetary theory will be considered, although this results in a rather summary statement of his position. Chapter VI is a discussion of his views as to control policy, with particular reference to the kind of price level policy which should be pursued if stability in the

economic system is to be maintained. In this section we shall also consider the other practical proposals which he makes in connection with his analysis of economic control measures. An effort is made to show how these proposals take their special character from the economic theory from which they are derived. In the concluding division, Chapter VII, the preceding sections are summarized and some general comments are made on the work as a whole.

CHAPTER II

HAWTREY'S MONETARY APPROACH TO BUSINESS CYCLE THEORY

HAWTREY once wrote that he believed the business cycle to be a "*purely* monetary phenomenon",[1] and this statement has often served to distinguish his writings for those who seek to classify doctrinal systems. It is necessary to make a careful examination of his writings, however, in order to form a judgment as to the meaning of this proposition. While it is obvious that Hawtrey may be classified as a "monetary" theorist so far as concerns his explanation of the business cycle, he presents a special version of the monetary approach. In this chapter we shall examine the various elements in his general approach to monetary and business cycle problems.

(1) *The power of monetary control devices.*

In the first place, it cannot be said that Hawtrey denies the possibility of using theories of over-confidence or over-production to explain certain aspects of the business cycle. One version of these ideas plays an important part in his own theory. He has argued that even though one might admit the causal significance of such factors it can be shown that states of over- or under-confidence and of increasing or decreasing rates of investment can be *controlled* by monetary devices. He writes as follows: ". . . it is money income that determines expenditure, expenditure that determines demand, demand that determines prices. Therefore the problem of regulating prices is reduced to the problem of regulating trade borrowing." Again,

1 *Monetary Reconstruction*, Second Edition (Longmans Green, London, 1926), p. 132. Later he writes: "The trade cycle is a monetary phenomenon because general demand is itself a monetary phenomenon." *Capital and Employment* (Longmans Green, London, 1937, p. 124). Here general demand means total money expenditures on finished goods.

" the volume of trade is amenable to human control " through the agency of the Central Banks, by varying the cost of loans.[2]

The possibility of monetary control is based, according to Hawtrey, on the theory that any force making for fluctuations in the rate of activity must work through credit developments if it is to realize its full effect. If the credit facilities do not exist the fluctuation is not accomplished.[3] So the control of the fluctuation is based on the control of the credit development. This view that fluctuations in business can be controlled by credit measures is characteristic of Hawtrey. There is this much evidence, then, that his monetary approach to the cycle may be taken to mean that substantial control power is imputed to monetary devices.

(2) *The monetary theory of the period of the cycle.*

But Hawtrey has written further in explanation of his position. He points out, " It is the *periodical* character of the fluctuations forming the trade cycle that I believe to be wholly due to monetary causes." [4] This view is developed to show that it is the rate of progress of credit developments that determines the extent and duration of the cycle; thus, " when credit movements are accelerated, the period of the cycle is shortened." [5] There are two significant aspects of this position. First, the emphasis is on the fluctuations which form the trade cycle, to the exclusion of other kinds of industrial changes. Presumably this rules out seasonal, secular, or random variations in the rate of economic activity. Second, it is the period-

2 *Monetary Reconstruction*, pp. 130, 132 and 134.

3 This is close, in a sense, to that element of Professor J. M. Clark's theory of the cycle that treats credit as an " enabling device." While Clark does take the position that credit may initiate disturbances he generally seeks the stimulus in other, non-monetary, factors. *Strategic Factors in Business Cycles* (National Bureau of Economic Research, New York, 1934), pp. 72-3. Hawtrey gives credit a far more prominent place in his scheme of things.

4 *Trade and Credit* (Longmans Green, London, 1928), p. 175. His italics.

5 *Ibid.*, p. 175.

ical character of these fluctuations which he feels can be explained only on monetary grounds.[6] Period means here the time over which the entire cycle is spread. These limitations are important to bear in mind in interpreting Hawtrey's theory. It is the periodical character of the *cycle* and not the *initiating* cause that is the core of his problem; in fact, this last may be any one of a "great variety of causes."[7] But these causes can only lead to a cycle if they are facilitated, or "enabled", as shown above, by appropriate credit developments. Likewise, the rate of progress of the cycle may be influenced by non-monetary causes, but these factors operate indirectly and through the medium of the credit movement. For example, a non-monetary factor such as optimism in a particular industry can affect activity directly, but it cannot exert a general influence on industry unless the optimism is allowed to reflect itself through monetary changes.[8] There are these two strands, then, in the theory that the cycle is a purely monetary phenomenon.

(3) *The importance of monetary equilibrium.*

We shall be concerned below with a detailed study of Hawtrey's equilibrium analysis, but at this point, for the purpose of further explaining his monetary approach, we can indicate that monetary equilibrium is conceived of as being fundamental to general economic stability. He has argued that if its conditions are maintained ". . . the stability of every other part of the machine follows."[9] Furthermore, if there is a deviation from monetary equilibrium, that is, if a credit contraction or expansion begins, this deviation tends to grow with cumu-

6 *Capital and Employment*, pp. 7-8.

7 *Trade and Credit*, p. 175. See *Capital and Employment*, p. 100, where different factors stimulating a release of cash to pay for increased capital outlay are listed. In *Trade and Credit* the "starting point" was found in "the endless fortuitous variations in the credit position and in traders' expectations, which are always occurring" (p. 98).

8 *Ibid.*, p. 176. Explicitly, through increased borrowing.

9 *Currency and Credit*, Third Edition (Longmans Green, London, 1927), p. 11. All references are to this edition.